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Entergy Corp.

Just What Are the Key Debates?

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What are the Key Debates? AMI, Nuclear Divestment, and DPS Growth

In short, AMI progress in coming months as testimony is delivered in coming weeks from Staff, the shift out from EWC (what kind of NDT 'top off' might be needed?), resulting dividend growth reacceleration (as the top end of the payout ratio at 75% is achieved), and a further debate on revaluation to a fully regulated utility framework remain the key debates. We note lingering concerns on nuclear capex recovery and execution on the sustenance plan remain a further, albeit seemingly abating risk.

The focus is now on ridding itself of the legacy nuclear liabilities

Mgmt's near-term goal remains just how and at what cost will mgmt. prove able to rid itself of the NDTs and associated liabilities to retire retired and to be retired nuclear plants, akin to the Vermont Yankee deal it inked recently. While mgmt's current FCF projections through the 5-year period indicate a cumulative ~$45 Mn loss, the goal remains to both top-off the NDTs prior to handing them over to any potential buyers (a negative impact to projected FCF) while also aspiring to source incremental cost reductions to drive towards a largely ~Break-even cumulative projection. We look for details in coming quarters around any prospective success in structuring such a deal for assets to be retired. We see this as more firmly closing out the merchant exposure and its gonging I/S and B/S impacts.

On the regulated side, its approvals for spend rather than the constructs

While regulators have historically authorized healthy ROEs and have attractive formulaic mechanisms, the critical question is the pace of ratebase growth and the ability to push ahead with the like of AMI spend. We see this as critical to future execution alongside recovery of legacy nuclear capex to driving confidence on achieving EPS growth targets.

Valuation: Maintain Sell, but nudging up our PT to $73 (from $70) on SOP

As management winds down EWC, we see an argument in favor of an increasingly regulated structure. That said, given continued merchant operations and uncertainty on ultimate FCF in NDT we believe investors will continue to use a more traditional valuation framework to net out prospective liabilities. We note our slight discounted P/E accounts for the relative opacity in disclosures. We look for DPS growth PE valuation, though we are not yet there today with a number of outstanding risks.

Framing the Key Issues Ahead for the Company

With many investors asking what's next, we attempt to frame the critical issues and strategies being pursued by management. Overall, the effort remains clearly oriented towards re-regulation and scaling down risk with the shutdown and now divestment of the legacy merchant nuclear portfolio. We see this divestment process as likely the next critical step, albeit unclear to what extent it is a positive. Mgmt's goal remains to offset the cost (effectively topping off of its NDTs) with additional savings to limit the impact to consumers. We note the transfer of the NDTs and retired plants to third parties could enable a further simplification of both the income statement and balance sheet.

Turning to the core regulated business, spend remains oriented towards several key buckets of recovery: the first being the nuclear reinvestment theme on its core regulated units. Resolution on spend either way should provide some view on being able to earn its Authorized ROE. Additionally, scaling opportunities around AMI in the near-term, but also an emphasis on owning its own generation appears a further long-term ambition. While the scale of the transition away from its legacy of purchased power remains opaque, we believe this could provide an element of growth above and beyond the organic opportunities afforded by the service territories core load growth trends.

Nuclear Decom –What now & How will ETR Get it off the Balance Sheet?

As the company wraps up the unregulated business, the question is just what happens to the nuclear plants. We see management as reticent to agree to a substantial liability but unlikely to choose to decommission the plants if at all possible. A reasonable 'top off' cost could be offset by a series of cost cuts, so management's roughly flatish (-$45M) cash flow guidance over the forecast period could still remain unchanged. Management remains adamant that the EWC wind down will be a cash neutral event. Though perhaps an imperfect way of fixing the issue, we don't view this as largely problematic assuming that management can ameliorate the situation similar to Vermont Yankee, with an acceptable decommission counterparty and any necessary top off.

In terms of winding down the EWC business, the company is focused on mitigating some of the remaining risks on the way towards the exit. One of the key opportunities here would be the remaining coal plants – rather than investing in emissions controls, the company has more effective opportunities to source new generation investment and phase out existing plants as needed. For example, the St. Charles project is expected to save $1.3B over the life of the plant. Additionally, buying distressed assets has been a further source of upside.

What's the Latest on the Generation Buildout?

We note some of the more recent developments below:

New Orleans: Entergy continues to push direct generation into the New Orleans region directly, as potential for storm damage keeps the city susceptible to a transmission line breakdown. In addition to an improvement in the peaking capacity, the company is looking to add 100MW of renewables in the region due at least in part to local demand for renewables (could we see more ratebased renewables along similar lines?). This follows:

Lake Charles: While the Lake Charles CCGT permitting took a relatively long time to complete, St. Charles by contrast should prove more forgiving as the company streamlines the processes. With the settlement agreement reached recently, we see items as moving forward here and the ALJ is currently taking it under consideration. Next steps would be to present it at the June B&E meeting.

Montgomery County: While the previous update had listed Montgomery county as under review, parties are currently working on a settlement. Texas appears generally supportive of further Texas-based generation (rather than buying out of state) so a settlement seems reasonable.

Figure 1: Updates to the regulated build

Generation Projects Overview	MW	OpCo	Estimated Cost ($M)	Est In Service	Status
St Charles	980	ELL	869	2019	Under Construction
New Orleans	226	ENOI	216	2019	Suspended - will file alternatives June/July
Lake Charles	994	ELL	872	2020	Settlement Agreement reached
Montgomery County	993	ETI	937	2021	Suspended - Working on Settlement
Washington Parish	361	ELL	TBD	2021	Purchase and Sale Agreement (CPN)
EAI CT	250	EAI	TBD	2022	Planning Assumption

Source: ETR, UBSe

Can ETR Shift from PPA's to Owned-Generation?

While there are some clearly enumerated opportunities above, we highlight ETR could yet find longer term optionality as other PPA's roll off. Though the company may include some of this already in the plan, we highlight the potential can be framed to a degree. Total TWh sold in 2016 include 112,595 GWh for retail and 11,054 for resale for a total of 123.649 TWh energy sales billed. Compare this to 9-10% in 2016 and 2017 listed in the 10K as total utility power purchased. While this may not necessarily be a PPA explicitly, it implies something in the range of 10-12 TWH of PPA's (this excludes any power purchased from MISO) using the basic math here. Total nameplate capacity for ETR's regulated fleet is ~24-25GW, so an average capacity factor would suggest a comparable % of replacement (1-2GW) which could be replaced. What isn't particularly clear is how much if any of the above chart would fall into this category.

AMI Is Next – Time to Play Catch-Up?

Entergy has a number of jurisdictions that need further AMI investment, and some areas (Louisiana) have even had some constituents lobby for faster deployment. On the other hand, the company does see real constraints to any increase in the speed of deployment and notes that a more measured pace of deployment could let the company learn from other best practices and realize the benefits from day 1. Although there are a number of moving parts to the filings across the 4 key AMI jurisdictions, we note Texas and Mississippi bear note in particular of late. The Texas legislature just passed the necessary law which will allow the full proceeding to move forward. In Mississippi, the latest AMI filing was approved as well. While there is always risk until the plans are fully approved, the company is relatively confident that these initial build-outs should proceed with relatively little issue. We perceive success in Louisiana and Arkansas as particularly relevant with testimony due shortly.

We provide a summary of the latest info elsewhere as well below.

Figure 2: ETR's AMI Regulatory Process

AMI Regulatory Process			
OpCo	Docket	Amount ($Mn)	Proposed Recovery Method
EAI	16-060-U	$208	2018 FRP
ELL	U-34320	$330	Customer charge starting 2019, updated annually until meters are fully deployed
EMI	2016-UA-261	$132	2018 FRP (Filing Recently accepted)
ENOI	UD-16-04	$75	Phased-in customer charge starting 2019
ETI	n/a	n/a	Filing expected 4Q17 (Recently passed law)

Source: ETR, UBSe

What About Nuclear Costs?

We highlight on the latest call that the company called out an accounting change coming around how to account for nuclear decommissioning trust earnings. This should allow the company to mark to market any realized gains the growth in the various trusts. Net net, this could allow a ~3% growth, getting to ~flat by 2022.

Almost Time to Shift the Debt Treatment?

As ETR moves increasingly away from EWC and towards regulated operations we note our existing valuation grows somewhat more punitive compared to pure regulated peers. While there is clearly a healthy level of holdco debt which still gives us pause, management sees credit agencies as more comfortable with the balance sheet of late, noting that holdco leverage is not significantly higher than peers and could yet be utilized. Current metrics stand at 17.3x FFO/Debt (13-23x target), 4.4x Debt/EBITDA (3.5-4.5x target), and Parent/Total Debt at 21.1% (18-20% target). Given recent positive sentiment from the debt community and a shift increasingly towards regulated only, we note the potential for a further discrepancy among our treatment of the debt. Whereas fully regulated peers generally receive a pure P/E treatment, our valuation currently nets out the debt which proves to be more punitive.

Improving the Dividend Further Is Key; Need to Execute on Utility to support future trajectory

As ETR shifts to fully regulated businesses, continued growth of the dividend will be key. We see management as continuing to target growth in line with EPS growth, yet this will be tied to the wider utility growth. The company would most likely increase EPS at a faster rate initially then feather into a comparable DPS growth. There would be no specific inflection point other than when the payout ratio reaches an acceptably low level to increase DPS in line with EPS (presumably in the next year or two. Nonetheless, management would need to achieve growth above our estimates to maintain the stated range (75% max). The question is whether re-acceleration would happen *ahead* of achieving this 75% trend,

Taking Note of Consensus

While EPS revisions had trended steadily down into the end of the year, street has moved in a more positive direction of late. We have updated our estimates nominally as shown below as well – seeing less clear upside to estimates aside for one-off potential tax items later this year and beyond. We believe EPS volatility due to historic one-off items add to uncertainty on consistent steady execution at core utilities. We remain modestly below mgmt's Utility & Parent guidance ranges through 2019.

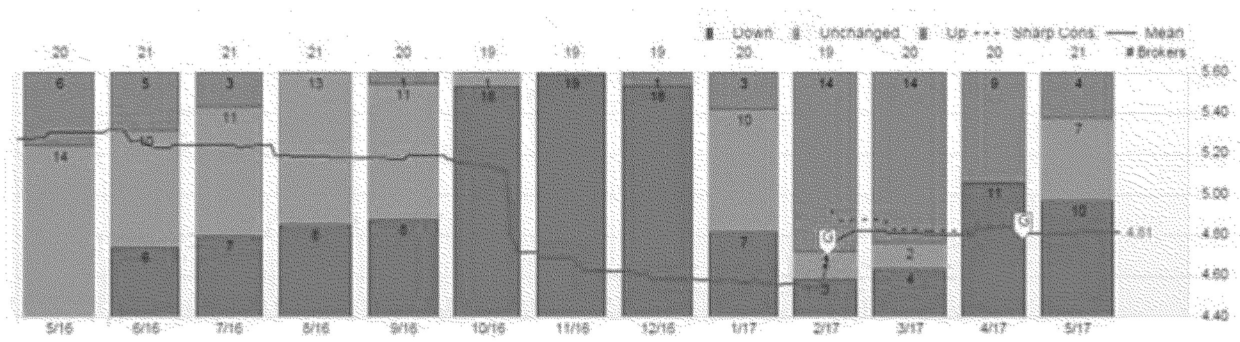
Figure 3: UBS EPS estimates

EPS by Segment	**2015A**	**2016A**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**
Regulated Utility	6.12	6.34	5.78	6.16	6.54	6.97	7.56
EWC/Nuclear	1.03	2.01	0.57	0.48	0.19	(0.21)	(0.47)
Other	(1.15)	(1.24)	(1.42)	(1.52)	(1.73)	(1.87)	(2.29)
Consolidated EPS	**6.00**	**7.11**	**4.93**	**5.12**	**5.00**	**4.89**	**4.80**
Prior UBSe	*6.00*	*7.11*	*4.80*	*5.02*	*4.99*	*4.90*	
Guidance (4Q16)			**4.75-5.35**				
Consensus (5/31/17)			*4.81*	*4.88*	*5.02*	*5.35*	*-*
Adj. Utility Parent & Other							
UBSe			**4.36**	**4.63**	**4.81**	**5.10**	**5.27**
Growth				*6.3%*	*3.9%*	*6.0%*	*3.2%*
High End Guidance Range			*4.55*	*4.90*	*5.30*		
Low End Guidance Range			*4.25*	*4.50*	*4.90*		
Regulated Guidance Midpoint (4Q16)			**4.40**	**4.70**	**5.10**		
UBSe vs. Midpoint			*-0.04*	*-0.07*	*-0.29*		
Guidance Ranges			4.25-4.55	4.50-4.90	4.90-5.30		5.20-5.60
Regulated Payout %			*81%*	*79%*	*78%*	*76%*	*75%*
UBS % Change			*3%*	*2%*	*0%*	*0%*	*#DIV/0!*

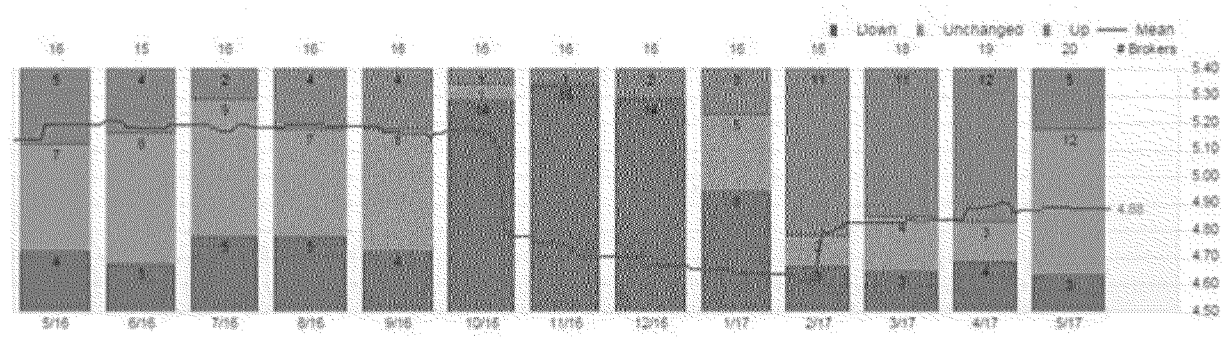
Source: ETR, UBSe

We highlight the latest consensus trends below, which have ticked up recently. The question is whether recovery of nuclear costs on the regulated costs can be resolved amicably along with support for its pending AMI dockets across its core geographies to support further revisions on earned ROEs (under-recovery on nuclear spend) as well as AMI capex (largely reflected in our & street projections we believe).

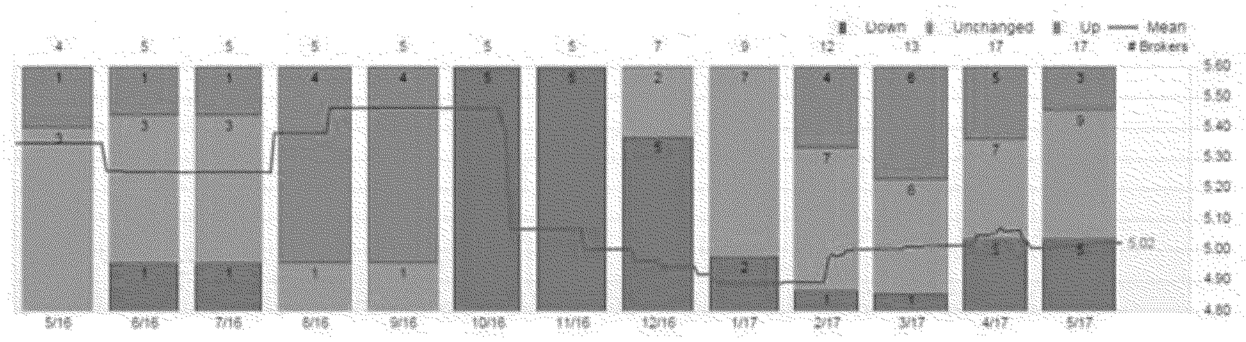
Figure 4: Estimate Revisions
2017 Consensus Ests



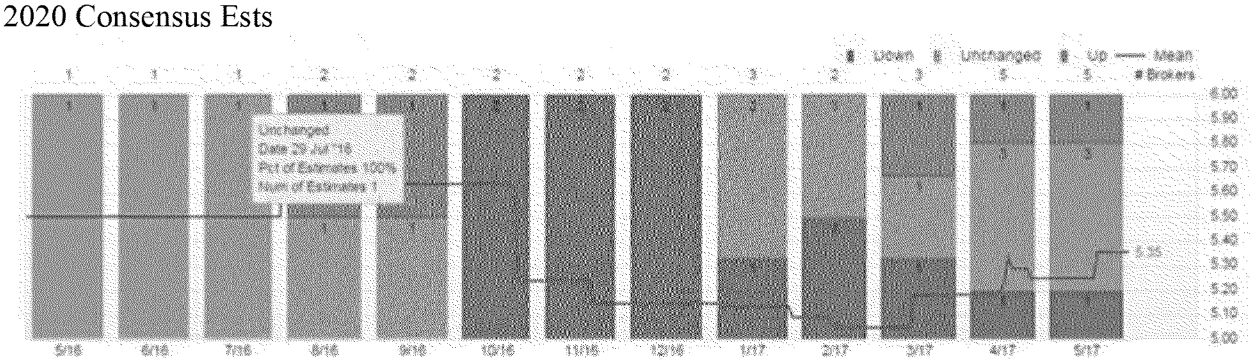
2018 Consensus Ests



2019 Consensus Ests



2020 Consensus Ests



Source: Factset

Price Target: $73

We include our Sum of the Parts below. We have updated our P/E multiple from 17.1X to 17.8 which increased the PT by $4/sh. Slight tweaks on the Utility estimates decrease our PT by -$1/sh, for a net increase of $3/sh.

Figure 5: Revised SOTP Valuation

Entergy Corp. Sum-of-the-Parts Valuation							
		P/E Multiple				Equity Value per	
	2019E EPS	**Low**	**Prem/Discount**	**Base**	**High**	**Low**	**Base**
Regulated Utilities		**2019 Peers**	**17.8x**				
System Energy Resources, Inc. (SERI)	0.44	16.8x	0.0x	17.8x	18.8x	7.33	7.76
Entergy New Orleans	0.26	15.8x	-1.0x	16.8x	17.8x	4.12	4.38
Entergy Mississippi	0.76	15.8x	-1.0x	16.8x	17.8x	12.01	12.77
Entergy Louisiana	3.28	15.8x	-1.0x	16.8x	17.8x	51.82	55.10
Entergy Texas	0.54	15.8x	-1.0x	16.8x	17.8x	8.49	9.02
Entergy Arkansas	1.29	15.8x	-1.0x	16.8x	17.8x	20.44	21.73
Other	(0.02)	16.8x	0.0x	17.8x	18.8x	(0.42)	(0.44)
Regulated Utility (Consolidated)	**6.54**					**103.79**	**110.33**
Parent Preferred Income	(0.69)	18.8x	0.0x	17.8x	16.8x	(13.02)	(12.33)
Other Parent Exp (non-Pfd)	(0.62)	18.8x	0.0x	17.8x	16.8x	(11.74)	(11.11)
Total Utility Equity Value per Share	**5.23**	*15.1x*		*16.6x*	*18.1x*	**$79.03**	**$86.89**
Parent Drag	**$Mn**	**Weighting**					
Senior Notes	(1,850)	100%		100%	50%	-1,850	-1,850
Drawn RCF	(700)	25%		25%	10%	-175	-175
Commercial Paper	(344)	50%		50%	25%	-172	-172
Cash and Cash Equivalent	13	100%		100%	50%	13	13
Total Parent Drag	**(2,881)**					**-2,184**	**-2,184**
2019E Shares Outstanding (Mn)						*183*	*183*
Total Parent Drag per Share						**(11.91)**	**(11.91)**
Merchant Generation Equity (Drag): NPV of FCF						(1,354)	(754)
EWC Net Cash (YE16)						-	388
Total EWC Drag						**(1,354)**	**(366)**
2019E Shares Outstanding (Mn)						*183*	*183*
Merchant Generation Equity Value per Share						**($7.38)**	**($2.00)**
Total Equity Value per Share						**$60.00**	**$73.00**

Source: Company filings, UBSe

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